March 31, 2023

KEC Spur Infrastructure Private Limited: Change in Limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-fund-based limits	70.00	467.00	[ICRA]AA- (Negative) /[ICRA]A1+; outstanding
Fund-based working capital limits	10.00	38.00	[ICRA]AA- (Negative); outstanding
Interchangeable CC Limits*	-	(15.00)	[ICRA]AA- (Negative) /[ICRA]A1+; outstanding
Unallocated bank limits	520.00	95.00	[ICRA]AA- (Negative) /[ICRA]A1+; outstanding
Total	**600.00**	**600.00**	

**Instrument details are provided in Annexure-1, * interchangeable with Long term/Short Term – Non-fund-based limits*

Rationale

While assigning the rating, ICRA has taken a consolidated view of KEC International Limited (KEC; rated [ICRA]AA-(negative)/A1+) and its subsidiaries, including its 100% subsidiary KEC Spur Infrastructure Private Limited (KSIPL). Collectively referred to as the Group/KEC/company, these companies are in similar lines of businesses and have significant operational and financial linkages, besides a track record of support extended by KEC to KSIPL.

The reaffirmation/assignment of ratings continue to factor in KEC's strong market position as an engineering, procurement and construction (EPC) company in the power transmission and distribution (T&D) segment coupled with an improving order book from the non-T&D segments as well. The company's order book reached the highest levels of Rs. ~28,981 crore as on December 31, 2022 (i.e. 1.81 times of TTM revenue), which provides strong medium-term revenue visibility. While the T&D segment dominates the company's order book mix (~46% as on December 31, 2022 vs ~50% as on March 31, 2022), the diversification has improved over the years with higher contribution from non T&D segments, such as civil (28%), railways (17%) and oil and gas (3%). Further, the company is expected to report its highest order intake at Rs. ~18,000-19,000 crore in FY2023 (Rs. 15,554 crore in 9MFY2023; Rs 17,203 crore in FY2022), driven by healthy capex demand among end users, especially the civil segment (including metros, airports, water, industrial and residential). Additionally, the company acquired KEC Spur Infrastructure Private Limited in FY2022 to foray into the oil and gas segment that would also allow revenue diversity over medium term as it scales up.

ICRA also takes cognisance of KEC's diversified geographical presence across the globe, deriving ~40-50% of its total revenues from overseas projects in the last few years. Moreover, KEC's demand prospects remain healthy because of the Government's focus on increasing infrastructure spending and the expected uptick in private capex cycle.

The ratings, however, are constrained by the high working capital intensity of the EPC business due to the long execution period of projects, milestone-based payments in the non-T&D businesses and the retention money requirement that is released post the defect liability period. This, in turn, results in dependence on short-term borrowing and extended credit period to the suppliers and sub-contractors, reflected in the relatively high ratio of total outside liabilities (TOL) to tangible net worth (TNW) estimated at 3.8-4.0 times times as on March 31, 2023 (PY: 3.5 times).

The ratings also remain constrained by the exposure of KEC's operating profit margins to the volatility in key raw material prices, particularly for international EPC contracts that are fixed price in nature. Headwinds in commodity prices, particularly steel, along with the weak performance of SAE Towers (SAE), lowered the operating margins to 4.6% in 9MFY2023 (6.8% in FY2022, 9.4% in FY2021 and 10.1% FY2020). SAE reported operating losses over FY2021-FY2023 on account of the cost and time overruns in T&D project execution in Brazil owing to pandemic-related challenges in addition to the commodity prices headwinds. However, the loss-making EPC projects in the standalone order book are expected to be completed by September 2023, while all SAE projects in Brazil have been completed in Q3FY2023. While the company follows a price hedging mechanism for commodities such as aluminium and zinc to minimise the commodity price risk, it remains exposed to the adverse movement in steel prices in case of the fixed-priced contracts.

Further, KEC's operations remain exposed to project execution risks arising from right of way challenges, geopolitical risks, currency fluctuations and counterparty credit risks, given its presence in many overseas countries. To mitigate the credit risks from overseas customers in regions such as Middle East, Africa and Central Asia, the company focusses on projects funded by multilateral agencies, insurance covers and hedges currency risk through forward contracts to a certain extent.

The negative outlook on the long-term rating of the company reflects weakness in the operating profitability as well as elevated debt levels that have persisted for longer than expected duration. While the company expects the operating margin profile to gradually improve over the next few quarters months, the extent of improvement in the same and coverage metrics, along with reduction in debt levels remains key monitorable from credit perspective.

Key rating drivers and their description

Credit strengths

Globally established and diversified EPC player with leadership position in domestic power transmission segment – In the last seven decades, KEC has diversified its business profile across segments and geographies. At present, the company executes EPC projects and provides supplies in various infrastructure-related verticals – power transmission and distribution (T&D), railways, civil, cables, solar, smart infra and oil and gas. It is one of the largest power transmission EPC companies in the world with presence in over 110 countries (includes EPC, supply of towers and cables). Further, it has recently acquired KEC Spur Infrastructure Private Limited (rated [ICRA]ICRA AA-/ Negative/ [ICRA]ICRA A1+) to foray into the domestic oil and gas segment. The company has also established itself as a leader in the domestic power transmission segment and is strengthening its presence in non-T&D segment.

Robust order book position provides healthy revenue visibility; improving diversification in non-T&D segments – KEC's order book stood at Rs. 28,981 crore as on December 31, 2022 on a consolidated basis (the highest levels), i.e. 1.81 times of the TTM revenues, thus providing strong medium-term revenue visibility. The T&D segment constituted ~46% of the order book as on December 31, 2022 (50% as on Mar 31, 2022 and 58% as on Mar 31, 2021), while the balance pertained to the non-T&D segment, thus suggesting an improved segment diversification. The company witnessed its highest order intake in FY2022 of Rs. 17,203 crore (45% YoY growth) with the non-T&D segment contributing ~57% of the order intake. In FY2023, KEC is expected to surpass FY2022 level in terms of order intake, with expected order inflows during FY2023 estimated at Rs 18,000-19,000 crore (Rs 15,554 crore in 9MFY2023).

Currently, the company is witnessing healthy demand from various end-user sectors, especially in civil segments such as metros, water, solar, data centres and residential, given the healthy private and government capex. However, the completion of projects within the agreed timelines, while maintaining the desired performance parameters, is critical to minimise the liabilities arising from project delays and performance issues. Further, the share of the T&D segment in the company's overall revenue mix has witnessed a gradual decline to ~51% in 9MFY2023 from ~67% in FY2020, indicating greater diversification into non-T&D segments.

Diversified geographical presence across the globe – KEC has a wide geographical presence, deriving a substantial portion of its revenues (40-50%) from overseas projects in the last few years. The company has an established presence in Middle East, Africa, Brazil, SAARC and South-East Asia areas. Further, international projects comprised ~28% of the order intake in 9MFY2023 and ~33% of the unexecuted order book position as on December 31, 2022.

Access to global markets and enhanced transmission tower manufacturing capacity from past acquisitions – The company has access to the global markets as a result of the acquisitions undertaken in the past. The acquisition of the US-based SAE Towers Holdings LLC (SAE) provided KEC access to the American markets for the design, manufacture and supply of transmission towers. The acquisition also increased KEC's manufacturing capacity for transmission towers with the addition of production facilities of SAE in Mexico and Brazil (annual tower production capacity of 1,00,000 metric tonnes). The company acquired a tower manufacturing facility in Dubai (50,000 metric tonnes capacity) in February 2020 that caters to the orders from the MENA region and has scaled up substantially since March 2021.

Credit challenges

High working capital intensity in EPC business and operating losses in certain large projects has led to elevated debt levels – The working capital intensity remains inherently high in the EPC business due to the long execution period of projects, milestone-based payments in the non-T&D businesses and the retention money requirement that is released post the defect liability period. As a result, the company's overall debtor days have remained high around 297 days in FY2022 (PY: 277 days). The debtor days are on the higher side since the receivables include retention money of projects and contract assets. Further, the debtor days increased in FY2022 primarily on account of the receivables stuck in Afghanistan projects as well as higher receivables from the railway segment on account of the changes in the invoicing mechanism. The working capital position is, however, supported to some extent by creditor days of 225-250 days. A high working capital intensity is further evident from the net working capital/operating income of 29% in FY2022 (PY: 25%) as well as TOL/TNW of 3.5 times as on March 31, 2022 (PY: 3.2 times). The working capital intensity is estimated to have been at a similar level till 9MFY2023, and expected to improve only Q4FY2023 onwards gradually, with normalization of certain large debtors in the railways and T&D segments.

Increased working capital requirements in addition to the losses at SAE Brazil and certain legacy projects in the standalone order book in FY2022 as well as 9MFY2023 have resulted in higher debt levels, with total net debt (including acceptances) of Rs. 5617 crore as on December 31, 2022 (Rs. 3391 crore as on Mar 31, 2021). The higher debt and moderated OPBIDTA levels deteriorated the debt metrics with interest coverage for 9MFY2023 at 1.45 times (2.3 times in FY2022 and 3.4 times in FY2021) and total net debt (including acceptances) to TNW at 1.6 times as on Dec 31, 2022 (1.4 times as on Mar 31, 2022 and 1.0 times as on Mar 31, 2021). However, with the expected improvement in operating profits and the reduction in debt levels, the debt metrics are likely to improve over the medium term

Intense competition in domestic and international markets for T&D business – KEC derives a significant proportion of its revenues (~51% in 9MFY2023 and ~48% in FY2022) from the transmission and distribution segment, which remains highly competitive in the domestic and international markets. However, the competition has moderated to an extent currently, with the restoration of bid-bond requirement for some PSUs, which was earlier removed as a part of the GoI's initiatives to support domestic small/mid-sized players.

Operating margins vulnerable to volatile raw material prices, particularly for fixed-price international EPC contracts – The cost of key raw materials for tower manufacturing (steel and zinc) and several other bought-out components required to install transmission line projects make up for KEC's raw material cost. Given the long order execution period of about 18-24 months, the operating margin remains vulnerable to the volatility in the prices of key raw materials, particularly for international contracts that are generally fixed-price in nature. Continued losses in SAE and headwinds in the commodity prices as well as logistics cost (especially for exports) coupled with time and cost over-runs during Covid-19, resulted in a decline in KEC's consolidated OPM in 9MFY2023 to 4.6%, after declining to 6.8% in FY2022 from 9.4% in FY2021. SAE reported significantly high operating losses during FY2021-9MFY2023 on account of cost and time overruns in executing the projects in Brazil (partially owing to Covid-19 challenges) in addition to higher raw material cost which could not be completely passed on the customers despite having price variation clause linked to inflation index of Brazil.

However, now with all the projects completed till Q3FY2023, the management expects SAE to earn meaningful operating profits from Q4 FY2023 onwards. Though SAE operations are expected to normalise by Q4 FY2023, its performance in the near to medium term and the impact on the consolidated financial credit profile of KEC will continue to be key monitorable. Nonetheless, incrementally the risk is mitigated to some extent by the commodity price hedging undertaken by the company.

Operations exposed to currency fluctuations, counterparty credit risks and geopolitical issues – Overseas projects continue to contribute significantly to KEC's overall revenues. Therefore, its operations are exposed to currency fluctuations, and counterparty credit and geo-political risks. However, the risk of currency fluctuations is mitigated to some extent by the natural hedge (expenses incurred in foreign currency), forward contracts and utilisation of foreign currency-denominated borrowings. The counterparty credit risk is also partially mitigated for international projects as most of them are funded by multilateral funding agencies.

Challenges to project execution from right-of-way – The company is exposed to project execution risks arising from right-of-way and geo-political issues for overseas and domestic projects. As a result, its ability to execute the projects in a timely manner within the budgeted costs remains critical from a credit perspective. Given that a few of its orders are in technologically-enabled areas such as urban infrastructure (metro electrification), flue gas desulphurisation, high-speed trains, hydrocarbons etc., where the company has recently forayed, the project execution risk is slightly higher. Nevertheless, this gets mitigated to an extent on account of project-specific technical collaborations/joint ventures entered.

Environmental and social risks

The company is exposed to the risks arising from tightening regulations on environment, specifically pertaining to discharge/treatment of effluents, and on the safety front. These have necessitated KEC to increase its investments towards meeting the evolving and tighter regulatory standards. The emissions/waste generated by KEC are within the permissible limits of the Central Pollution Control Board (CPCB)/State Pollution Control Board (SPCB). Also, there were no pending show cause/ legal notices from CPCB/SPCB at the end of FY2022. This indicates that KEC has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance.

As per the KEC's disclosures, the company continues to focus on capability building by creating a talent pool, through dedicated talent pipelines and competency upgradation through behavioural, technical, functional, and digital learning and development initiatives. Additionally, customer satisfaction remains critical for KEC's successful operations and for ensuring the same it conducts surveys on a regular basis and has achieved a satisfaction rating of 88.5% in FY2022 (PY: 83.5%). Further, slowdown in infrastructure investments can lead to lower order intake and thus lower sales, however, with KEC being highly diversified with respect to end-users as well as geography, this risk is mitigated to an extent. Therefore, while KEC remains exposed to the aforementioned risks, it does not materially affect its credit profile.

Liquidity position: Adequate

The company's liquidity profile is adequate with the presence of free cash balance of over Rs. 180 crore as on December 31, 2022 and average cushion in drawing power of around Rs. 1,330 crore in 9MFY2023. Further, retained operating cash flows are likely to improve to healthier levels in FY2024 with the betterment of operating margins with execution of projects with better profitability and expectations of gradual improvement in working capital cycle. ICRA expects KEC to comfortably meet its debt repayment obligations of ~Rs. 72 crore (in SAE) in FY2023. ICRA also notes that KEC is expected to incur a maintenance capex of ~Rs. 200-225 crore per annum in the medium term.

Rating sensitivities

Positive factors – ICRA could revise KEC's outlook to stable if the company is able to demonstrate an improvement in operating profitability in a sustained manner. Further, significant reduction in the working capital requirement, causing the TOL/TNW to fall below 3.5 times on a sustained basis will also support a revision in outlook.

Negative factors – The ratings can be downgraded if the company's working capital intensity increases, leading to an increase in the TOL/TNW to more than 4.0 times on a sustained basis. The ratings may also be affected if KEC is not able to improve its operating profitability above 8% on a sustained basis or if there is any sharp decline in fresh order inflows, affecting the order book position and revenue growth prospects.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology](#) [Methodology for Construction Entities](#)
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. The list of companies that are consolidated to arrive at the rating are given in Annexure 2 below.

About the company

KEC Spur Infrastructure Private Limited (KSIPL), a wholly owned subsidiary of KEC International Limited (KEC), is an Indian EPC company engaged in the setting up of cross-country oil & gas pipelines and city gas distribution networks. The company was incorporated in March 2016 as Spur Infrastructure Private Limited and was acquired by KEC in October 2021 post which the name of the company was changed to KEC Spur Infrastructure Private Limited in February 2022. KSIPL is executing projects for customers such as Indian Oil Corporation Limited (IOCL), Gas Authority of India Limited (GAIL), IHB Ltd., Indraprastha Gas Limited (IGL) and Bharat Gas Resource Limited (BGRL). Further, KSIPL's acquisition will provide KEC access to the parent's technical knowhow and relevant pre-qualifications which will enable it to capture growth opportunities in the oil and gas cross-country pipeline EPC sector.

KEC was established in 1945 and was taken over by R. P. Goenka (RPG) Enterprises in 1982 and renamed KEC International Limited in 1984. The company executes power transmission and distribution, railways, civil and solar projects on an EPC basis. It also manufactures power and telecom cables. KEC is one of the largest power transmission EPC companies in the world with presence in over 70 countries and a strong presence in India, the Middle East, Africa, South Asia the Americas and Central Asia. In September 2010, KEC acquired SAE Towers LLC, headquartered in Houston (USA), which is involved in the business of design, manufacture and supply of transmission towers. At present, KEC has three tower manufacturing facilities in India (Nagpur, Jaipur and Jabalpur) and one tower manufacturing facility each in Mexico, Brazil and Dubai, with a combined manufacturing capacity of 3,62,200 metric tonnes per annum (MTPA). KEC also has cable manufacturing (power and telecom) facilities in Mysore and near Vadodara with a combined capacity of 48,000 MTPA in addition to 12,000 MTPA of solar manufacturing capacity.

Key financial indicators

KEC Consolidated	Audited	Audited
	FY2021	FY2022
Operating Income (Rs. crore)	13,114.2	13,742.4
PAT (Rs. crore)	552.7	332.1
OPBDIT/OI (%)	9.4%	6.8%
PAT/OI (%)	4.2%	2.4%
Total Outside Liabilities/Tangible Net Worth (times)	3.2	3.5
Total Debt/OPBDIT (times)	1.7	3.3
Interest Coverage (times)	3.4	2.3

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)							Chronology of Rating History for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Jan 31, 2023 (Rs. crore)	Date & rating in FY2023				Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Mar 31, 2023	Feb 22, 2023	Sep 6, 2022	Apr 27, 2022	-	-	-
1	Non-fund-based limits	Long term/ Short Term	467.00	140.62	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	-	-	-	-
2	Fund based working capital limits	Long-term	38.00	6.00	[ICRA]AA-(Negative)	[ICRA]AA-(Negative)	[ICRA]AA-(Stable)	-	-	-	-
3	Interchangeable CC Limits	Long term/ Short Term	(15.00)	-	[ICRA]AA-(Negative)/ [ICRA]A1+						
4	Unallocated Limits	Long term/ Short Term	95.00	-	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	Provisional [ICRA]AA-(CE) (Stable)/ Provisional [ICRA]A1+ (CE)	-	-	-

Amount in Crores; Source: Company

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long term/Short Term – Non-fund-based limits	Very Simple
Fund based working capital limits	Simple
Interchangeable CC Limits	Simple
Long Term/ Short Term – Unallocated	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Non-fund-based limits	NA	NA	NA	467.00	[ICRA]AA-(Negative)/ [ICRA]A1+
NA	Fund based working capital limits	NA	NA	NA	38.00	[ICRA]AA-(Negative)
NA	Interchangeable cash credit limits	NA	NA	NA	(15.00)	[ICRA]AA-(Negative)/ [ICRA]A1+
NA	Unallocated limits	NA	NA	NA	95.00	[ICRA]AA-(Negative)/ [ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidated Approach
RPG Transmission Nigeria Limited	100.00%	Full Consolidation
KEC Investment Holdings, Mauritius	100.00%	Full Consolidation
KEC Global Mauritius	100.00%	Full Consolidation
KEC Power India Private Limited	100.00%	Full Consolidation
SAE Towers Holdings LLC, United States (along with step-down subsidiaries)	100.00%	Full Consolidation
KEC International (Malaysia) SDN BHD	100.00%	Full Consolidation
Al-Sharif Group and KEC Ltd. Co, Saudi Arabia	51.1%	Equity
KEC Towers LLC, Dubai, UAE	100.00%	Full Consolidation
KEC EPC LLC, Dubai, UAE	100.00%	Full Consolidation
KEC Spur Infrastructure Private Limited (formerly known as Spur Infrastructure Private Limited)	100.00%	Full Consolidation

Source: *Company*

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